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In the Supreme Court of the United States

OCTOBER TERM, 1968

No. 803

FIRST NATIONAL BANK IN ANOKA
Petitioner

vs.

EDWARD R. KENNEALLY, TRUSTEE IN BANKRUPTCY OF REED PLUMBING, HEATING AND AIR CONDITIONING, INC.
Respondent

RESPONDENT'S BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

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333-3539 Hayward-Court Brief Prtg. Co., Mpls., Minn. 55415 333-3530

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QUESTIONS PRESENTED

The respondent feels that there is no merit or substance to petitioner's questions.

STATUTES INVOLVED

Section 60 a (1) of the Bankruptcy Act of 1898, as amended, 11 U.S.C. 60 a (1), which provides:

> A preference is a transfer, as defined in this title, of any of the property of a debtor to or for the benefit of a creditor for or on account of an antecedent debt, made or suffered by such debtor while insolvent and within four months before the filing by or against him of the petition initiating a proceeding un-

> der this title, the effect of which transfer will be to enable such creditor to obtain a greater percentage of his debt than some other creditor of the same class.

Section 301.30(2), Minnesota Statutes Annotated which provides:

> Subdivision 2. Authority. All officers shall, respectively, have such authority and perform such duties in the management of the business of the corporation as may be prescribed in the by-laws, or, in the absence of controlling provisions in the by-laws, as may be determined by the board of directors.

STATEMENT

Petitioner's statement of the matter involved fails to put before this Court a correct statement of the case. Had petitioner done this it would be very clear that the reasons for granting the writ are not present in this case. Specific instances of these incorrect statements which need clarification or correction, or completion, are hereinafter set out by specific reference to the record.

(1) In regard to the validity of the instruments.

Petitioner at page 5 of its petition in a purported summary, creates the wrong implication in regard to the validity of the instruments by failing to set forth the finding of the Referee and failing to show that the Court of Appeals agreed with the Referee. Respondent is thus compelled to set forth the precise findings and the reasons stated for them.

The Referee in regard to the instruments in Finding XVII (Appendix 26)[1] held:

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[1]References are made to Petitioner's Appendix. Where they are otherwise, the reference will be to Respondent's Supplemental Appendix.

> "The assignment of the receivables to the bank (Paragraph XIII hereof) and the factor's lien agreement (Paragraph XV hereof) did not constitute valid corporate transfers to the bank of property of the bankrupt corporation, both instruments having been executed by Albert F. Reed alone."

The District Court, on the other hand (and as stated by the Court of Appeals, (Appendix 53) "held that the factor's lien and the assignment were validly executed corporate instruments because: the bank was not responsible for knowing and following the corporate by-laws: * * *"

The District Court stated: (Appendix 45)

> "In circumstances such as these, especially where, as here, a corporate certificate has been filed, the Court finds no case holding a bank or lender responsible for knowing and following the corporate by-laws of its borrower."

The Court of Appeals rejected the District Court's reasoning and emphatically stated: (Appendix 53)

> "We agree with the referee's conclusion that the security instruments were invalid."

The Court of Appeals then stated its reasons (Appendix pages 53-55) citing among other cases, *Bloomingdale v. Cushman,* 134 Minn. 445, 159 N.W. 1078, 1080 (relied on by the referee, Appendix 26) thus rejecting the District Court's reasoning as contrary to Minnesota law.[2]

The misapprehension created by petitioner's statement of the facts is the complete failure to point out that the

[2]It is well settled that the findings of fact of the lower Court may be set aside if clearly erroneous, or not supported by substantial evidence, or against the clear weight of the evidence, or if based on an erroneous view of the law.

Court of Appeals affirmed the Referee's conclusion that the security instruments were invalid.

(2) In regard to the matter of preferential transfer.

Nowhere in petitioner's Statement does it show what the Court of Appeals held in regard to the important matter of preference. On the matter of preference, it is to be noted that the Court of Appeals held that the trustee had proved the necessary elements to establish a voidable preference. The Court of Appeals held: (Appendix 50)

> "We hold that the security instruments were not valid, did not bind the corporation or estop the trustee and that payments received by the bank under these instruments were preferential under #60 of the Bankruptcy Act (11 U.S.C. #96)."

(The detailed holdings of the Court of Appeals are to be found at pages 58, 59, 60 and 61 of the Appendix.)

(3) In regard to the proceeds of the $16,000 note.

Petitioner at page 4 of its Statement has chosen again to paraphrase. A clearer and more accurate statement is contained in the record as follows: The Referee in his finding XVI stated: (Appendix 25)

> "The note (signed by Albert F. Reed as president and by Marcella Reed, absent the word, 'Secretary') is for $16,000.00 composed of: New money advanced by the bank: $4,563.06; antecedent indebtedness: $11,436.94; total $16,000.00"

and continuing a little later,

> "Total corporate indebtedness to the bank as of April 8, 1964: $16,000.00.

"Balance due as of the date of bankruptcy-shown in bank's claim No. 17: $6,904.64.

"Repayment made to the bank between April 8, 1964 and the date of bankruptcy: $9,095.36."

(4) Lastly it may be pointed out that the Statement of Petitioner found at page 5 (the last paragraph thereof) is replete with inaccuracies and incomplete statements. It is not possible for respondent to dissect these with brevity. Rather respondent would urge this Court to refer to the Opinion of the Court of Appeals found in the Appendix of Petitioner's Petition commencing at page 49.

ARGUMENT

Preface

The petition presents no case of particular importance other than to the immediate litigants and does not come within the type of case reviewable by this Court on Certiorari.

I.

THE COURT OF APPEALS DID NOT MAKE ITS OWN FACTUAL DETERMINATIONS.

The petitioner's statement (Petition, page 7) that "No basis whatever exists in the record for the finding by the Court of Appeals that, 'It is conceded that the bankrupt was insolvent as of April 8, 1964' " is completely without foundation.

The Court of Appeals made its determination on the record before it. At the request of the trustee, the Court of Appeals had physically before it on oral argument, all of the Exhibits offered on the trial before the Referee, including Exhibit 17.

Exhibit 17, the General Journal and General Ledger of bankrupt,[3] which was received in evidence without any objection by the petitioner-bank, clearly shows insolvency is not and was not, in fact, an issue in dispute in this case. It shows the liabilities to be $61,740.27 and the assets to be only $41,077.26, which clearly spells out insolvency. The Court of Appeals, on the state of the record before it, was correct in saying that insolvency was conceded as of April 8, 1964, the date of transfer.

Likewise petitioner's statement (Petition, page 6) that the Court of Appeals, by implication and directly found that Albert Reed signed the security instruments after Mrs. Reed signed the note and that no evidence was adduced by the trustee to support such finding, is without foundation. The Court of Appeals did not make its own factual determination, but based it on the Referee's findings supported by the record.

The Referee in his Finding VI (Appendix 14) stated:

> "At all the times material herein, the officers, directors and stockholders of the bankrupt were: * * *
> "Marcella Reed, secretary and director holding ten per cent of the corporate stock, * * *"

The Referee in his Finding XVII (Appendix 26) stated:

> "There is no evidence in the record . . . (3) that the shareholders and/or board of directors of the bankrupt corporation knew or had reasonable cause to believe that Albert F. Reed, Jr. as president of the bankrupt corporation had undertaken to obligate the bankrupt corporation to the First National Bank of Anoka by solely executing and delivering such instru-

[3]The Court is respectfully referred to Respondent's Supplemental Appendix hereto attached, and the summary of Exhibit 17.

ments to said bank without the joint signatures thereon of himself and the secretary of the bankrupt corporation."

Also. it is to be noted that the Referee ruled out any intentional ratification by Marcella Reed. Assuming, for the sake of argument only, that Marcella Reed might have had notice that a factor's lien and assignment of accounts receivable were asked for, there is nothing in the record to show that she consented or agreed to this request. In stating his reasons for so finding, the Referee stated (Appendix 24):

"That Marcella Reed was not available at the time the factor's lien was signed; that the note and factor's agreement were not signed contemporaneously but were signed on separate and different occasions, and that Marcella Reed may have refused to sign the factor's lien agreement because of its crippling effect on the business operation of the bankrupt corporation."

Thus respondent has shown that the Court of Appeals did not make its own factual determinations, but affirmed the Referee's findings.

II.

THE COURT OF APPEALS CORRECTLY APPLIED MINNESOTA LAW AND IN SO DOING AFFIRMED THE REFEREE.

Petitioner at page 8 of its petition and without any reference to the appendix or the record, and without any basis in fact, and contrary to the record of this case, states:

"The Court of Appeals in finding, without the benefit of any evidence or even any allegation in the

pleadings in the record, that Albert Reed was a wrongdoer, applied the law of the state applicable to the exception applied only in cases of fraud or wrongdoing."

It is to be noted that the Referee in Paragraph I of his Findings (Appendix 12) summarized the trustee's pleadings, and in part stated:

"In his petition, the trustee alleges in substance—
4. Subsequent to the assignment of the receivables mentioned in foregoing (3) and prior to the date of bankruptcy herein, the bank obtained a factor's lien agreement covering the bankrupt's inventory, which constituted a preferential transfer within said Section 60 of the act, and further, the factor's lien agreement is invalid as against the trustee for the reasons (a) that it was not executed as a corporate instrument and (b) was without a valid and present consideration."

It is to be noted, also, that the Referee found on the state of the record before him (Finding XVII, Appendix 26):

"There is no evidence in the record made in the controversy now at bar that justifies the conclusion (1) that the president of the bankrupt corporation had any authority to execute alone and by himself the instruments here under the trustee's attack or (2) that plenary authority to execute such instruments existed in the president of the bankrupt corporation alone, based by implication upon the fact that the president had been accustomed to exercise such authority with the consent and acquiescence of the other directors and stockholders of the bankrupt corporation or (3) that the shareholders and/or board of directors knew or had reasonable cause to believe that Albert F. Reed, Jr., as president of the bankrupt corporation, had undertaken to obligate the bankrupt corporation to the First National Bank of Anoka by solely execut-

> ing and delivering such instruments to said bank without the joint signatures thereof of himself and the secretary of the bankrupt corporation."

And again in Finding XVII (Appendix 26) the Referee said:

> "The assignment of the receivables to the bank (Paragraph XIII hereof) and the factor's lien agreement (Paragraph XV hereof) did not constitute valid corporate transfers to the bank of property of the bankrupt corporation, both instruments having been executed by Albert F. Reed, alone."

Statutory Notice of Minnesota Statutes 301.30.

The Referee correctly applied the law of Minnesota as set forth in the case of *Bloomingdale v. Cushman,* 134 Minn. 445, 159 N.W. 1078 that the petitioner herein was chargeable with notice of the statute under which the bankrupt company was incorporated, and as the Minnesota Statute (301.30(2)) required the company to prescribe the duties of its officers within its certificate of incorporation or in its by-laws, petitioner herein, was chargeable with notice of the powers of such officers as so prescribed. The by-laws of the corporation, which was trustee's Exhibit 2 on trial, required the signatures of two officers, namely its president and secretary.

Actual Knowledge.

The Referee found on the evidence that the bank had complete notice and knowledge of the corporate requirements of the signatures of both the president and the secretary, to-wit Albert F. Reed, Jr. President, and Marcella E. Reed, Secretary, in order to have a valid corporate instrument.

The Referee also found (Finding VII, Appendix 14-15) that the above referred to requirements were filed with the bank and at all times material herein were in the bank's possession and known to and by the representatives of the bank who engaged in the loan transactions.

The Court of Appeals affirmed the Referee. In so doing, the Court of Appeals correctly applied Minnesota law and in so doing stated (Appendix 55) that while knowledge may be imputed to a corporation, the knowledge must be that of an officer, other than the wrongdoer, if the corporation is to be bound citing *Ft. Dearborn Nat. Bank v. Seymour,* 75 Minn. 100, 77 N.W. 543; *Restatement, Section, Agency,* #91, 272 Comment c. and 2 *Fletcher on Corporations,* Sec. 758-59, pp. 1087, 89. In *Danglade & Robinson Mining Co. v. Mexico Joplin Land Co. et al.,* 190 S.W. 35 it is pointed out that a wrongdoer may be one who does an unauthorized act.

Thus, it is shown that the Court of Appeals correctly applied Minnesota law and in so doing, affirmed the Referee. Its decision does not represent a change in the law of the State of Minnesota. Nor will its impact be felt on the lending and financial institutions as argued by petitioner (without any record support or otherwise). Their loans are not affected. It may be assumed that such loans are secured by validly executed instruments. Each case must be treated on its own particular set of facts and in the instant case, invalid securities are involved.

III.

THE COURT OF APPEALS IN ITS FINDING OF PREFERENCE CORRECTLY APPLIED EQUITABLE PRINCIPLES.

Petitioner argues that the Court of Appeals erred in not applying equitable principles and the rule that the bankruptcy court functions essentially as a court of equity. Petitioner would also argue that "fair-play" has not been applied because the decision of this Court of Appeals is not consistent with Chapter 9 of the Uniform Commercial Code.

As for the Uniform Commercial Code (which itself lays down legal requirements as to execution of documents) it is not involved in this case since it was not adopted in Minnesota until July of 1966 and it does not have retroactive effect on the transactions of the instant case which took place in the first half of the year 1964. As for "fair-play" as urged by petitioner, respondent will hereafter point out that the Court of Appeals in applying the preference law and principles of bankruptcy law was indeed applying "fair-play" in equity of distribution, the very cornerstone of bankruptcy law.

On the matter of preference the Court of Appeals held that the trustee had proved the necessary elements to establish a voidable preference. (Appendix, pages 58, 59 and 60.) The Court of Appeals held:

> "The trustee, to prevail must prove the seven elements which make up a voidable preference. Bankruptcy Act. #60 (a) and (b), 11 U.S.C. #96(a) and (b). Of these elements, we are concerned with two, (1) Did the bank have reasonable cause to believe the

debtor insolvent at the time of the transfer; and (2) did the transfer enable the bank to obtain payment of a greater percentage of its debt than some other creditor of the same class?

"The referee found that the trustee had established the first element but not the second. The District Court found that the trustee had established the second, but not the first. Both agreed—no preference."

The Court of Appeals held:

"We are not convinced that the referee's finding that the bank had reasonable cause to believe that the corporation was insolvent is clearly erroneous."

Also, it held:

"We also hold that the trustee introduced sufficient evidence to establish the greater percentage element."

The Court of Appeals held further: (Appendix 50)

"We hold that the security instruments were not valid, did not bind the corporation or estop the trustee, and that the payments received by the bank under these instruments were preferential under #60 of the Bankruptcy Act. (11 U.S.C. #96)."

Once the Court of Appeals found preference, then the Federal Bankruptcy Law preempted the field and any state law to the contrary would have no application.

To treat petitioner specially, as argued by petitioner, would be in derogation of Section 60 of the Bankruptcy Act. It has often been said that the purpose of Section 60 of the Bankruptcy Act is to secure the equality of distribution among creditors which is contemplated by the Bankruptcy Act, and the right to avoid a preference is based on

the theory that equality among creditors of the same class *IS* equity and that it is a better administration of justice that there should be such equality than that a favored few, even though they may be diligent, should receive the lion's share of the estate. 8A *C.J.S. Bankruptcy,* Sec. 213, page 2. In 4A *Collier on Bankruptcy,* 14th Ed. p. 558 it is pointed out that "the trustee has been given extensive powers to set aside preferential or fraudulent transfers or transfers otherwise voidable under applicable state or federal law where the bankrupt would be estopped to do so."

It is certainly noteworthy that the Referee in his purported exercise of equitable power to estop the trustee, repeatedly said "Without taking into account the trustee's claim of preference . . ." (Finding XVI, App. 25); "Disregarding for the moment the trustee's preference claim . . ." (Finding XVII, App. 25) and "Without reference to the trustee's preference claim:" (Finding XVIII, App. 28).

It was without reference to the trustee's preference claim that the Referee arrived at his holding of an equitable lien (on which he was reversed).

It is clear thus, that the holding of the Court of Appeals in the instant case, rather than being in derogation of equitable principles, has in fact, upheld the very principles of the Bankruptcy Act, equality of distribution.

CONCLUSION

The petition presents no questions of sufficient substance to warrant review by this Court.

WHEREFORE it is respectfully submitted that the petition for a writ of certiorari should be denied.

Respectfully submitted,

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SUPPLEMENTAL APPENDIX

Exhibit 17 is the General Journal and Ledger of bankrupt showing the corporate assets and liabilities at various periods of time during the existence of the corporation.

The following assets are shown by the separate general ledger sheets for the date of March 31, 1964.

Cash	$93.76
Cash in Bank (1st Natl. Bk.)	1,472.42*
Accounts Receivable	26,123.10
Reserve for Bad Debts	100.00*
Inventory Materials & Parts	11,300.00
Prepaid Insurance	1,139.35
Equipment (autos & trucks)	4,503.50
Equipment Shop	139.50
Reserve for depreciation	640.00*
Misc. clearing accounts	9.53*
Total	$41,077.26

The following liabilities are shown by the separate general ledger sheets for the date of March 31, 1964.

Accounts payable	$24,980.62
Rent payable	400.00
Notes payable (bank inventory)	12,100.00
Notes payable (bank trucks)	4,300.00
Jarnig	8,650.00
Accrued payroll	411.65
Social Security payroll	498.76
Federal withholding	577.20
State withholding	153.00
Pipe trade vacation	143.30
Sheet metal vacation	131.75
Compensation taxes	263.99
Reserve for property taxes	140.00
Total	$52,750.27
Capital Investment	8,990.00
	$61,740.27

* indicates deficit